STIKEMAN ELLIOTT

Banking Law Update

January 2004

The *Limitations Act*, 2002

IN OUR RECENT *Business Law Update* (November 2003), we set out in general terms how the *Limitations Act*, 2002, due to come into force on January 1, 2004, radically changes the time frame for bringing a lawsuit in Ontario. This update focuses on those provisions particularly relevant to banking. As in other commercial areas, the prohibition on contracting out of the Act's limitation periods is likely to cause most concern.

Demand Notes

The introduction of the basic limitation period of two years is one of the key features of the Act. The clock starts ticking from the day on which a "claim" is discovered. "Claim" is defined at the beginning of the Act as "a claim to remedy an *injury, loss or damage*" that occurred as a result of an act or omission (our italics). Case law has established that promissory notes payable on demand create an obligation to pay from the time the note is created and this may start the clock running on the limitation period, notwithstanding that at that time no loss or damage has occurred. Even though "debt" is not part of the definition of claim, a claim on a promissory note will commence on the day it is created if existing case law continues to be relevant under the Act. Since "claim" was not previously defined under the old Act, there is an argument that as it now is under the new Act, the definition should not include demand debt such as promissory notes, or not at least until loss or damage has actually occurred under the notes (ie demand being made and failure to pay). However, until this point has been judicially determined, it is more prudent to treat the effect of the new legislation as reducing the limitation period for enforcing payment on promissory notes from six years to two.

Acknowledging Liability

Case law also makes it clear that an acknowledgement of a debt re-starts the limitation period on demand notes. Acknowledgement can take many forms – partial payment, payment of interest or written acknowledgement of the debt. Section 13 of the Act specifically deals with acknowledgements of liability. If a person acknowledges liability in respect of a claim for (1) payment of a liquidated sum, (2) the recovery of personal property, (3) the enforcement (or relief from enforcement) of a charge on personal property, or (4) other enumerated claims, the claim is effective on the day on which the acknowledgement was made. Accordingly, the two-year period begins again on the date of discovery of this acknowledgement.

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The prudent approach will be to continue to provide for a written acknowledgement of the debt relating to a demand note to the extent not otherwise specifically acknowledged.

Section 13 also codifies existing case law in relation to the effect of acknowledging particular types of liability. For example an acknowledgement of liability on a claim for interest is an acknowledgement of liability for the principal and an acknowledgement of a claim to realize on or redeem collateral under a security agreement is an acknowledgement by somebody else who later comes into possession of it.

These acknowledgements must be made to the person with the claim, the person's agent or an official receiver or trustee under the *Bankruptcy and Insolvency Act* (Canada). As a general rule, the acknowledgement must be in writing and signed by the person making it or the person's agent, although this does not apply to claims by the creditor for realization or by the debtor for redemption of the collateral under the agreement or to part payment of a liquidated sum.

Ultimate Limitation Period

One of the other key features of the Act is the introduction of the ultimate limitation period of 15 years. Section 15(6)(c)of the Act states that, for the purposes of the ultimate limitation period, the period begins in the case of a default in performing a demand obligation "on the day on which the default occurs".

It is not clear whether the day of default is the day the demand promissory note was made (in line with the interpretation of existing case law discussed above) or the date on which the debtor failed to comply with a demand for payment. This latter argument may be more attractive on the basis that debtors are not really expected to pay until a demand has been made and until this point of time no "loss" has crystallized or occurred. Whether this interpretation is correct remains to be seen, but again the emphasis should be on continuing to require debtor acknowledgements of the debt and assuming the existing case law and approach applies until otherwise decided.

No Limitation Period

Under Section 16 of the Act there is no limitation period at all in a number of proceedings. These are set out in full in our general Business Law Update. The two which are particularly relevant to the banking practice area are a proceeding by a debtor in possession of collateral to redeem it and a proceeding by a creditor *in possession* of collateral to realize on it (our italics). Note also that some specific limitation periods remain in force under certain Acts (e.g. the Mortgages Act, Personal Property Security Act, Bulk Sales Act, Commodity Futures Act).

Guarantees

The act is also silent on guarantees. Although guarantees generally take the form of a demand obligation, the guarantor becomes obliged to pay the debt of the principal debtor only if the person primarily liable fails to perform. Where a guarantor contracts to pay upon failure to pay of the debtor, the demand must be made before an action can be brought against the guarantor. Typically, the clock will start ticking for the limitation period when the debtor fails to pay as that is when the "claim" against the guarantor arises. It may also be at that time that demand for payment is made to the guarantor (in some cases, it may not be made at that time for strategic reasons). Under the Act, then, the limitation will again be reduced to two years, subject to the creditor obtaining acknowledgement of the guarantee liability.

A few issues arise from this. Creditors in insolvency proceedings against a debtor in some circumstances do not immediately make demand or commence a claim under a guarantee. With the reduced limitation period, any such claims must arguably be brought within two years of the initial failure to pay by the debtor on the basis that that is the date the creditor became aware of a claim for loss. This may be even more problematic where there is a stay of proceedings in an insolvency scenario with respect to the guarantor where it is in similar circumstances to the debtor. An order to lift the stay to make the demand may have to be sought in circumstances where demand has not been made. Furthermore, in other circumstances, it is perfectly possible that a remedy against the principal may be statute barred by the Act but not against the guarantor, who may remain liable as the limitation period under a guarantee may not have expired even though it has expired on the principal debt.

Contracting out of the Act's limitation periods

Under the existing law of limitations, parties can agree to lengthen or shorten or not to enforce limitation periods. However, under the new Act parties can no longer contract out of a limitation period. Section 22(1) provides that: "A limitation period under this Act applies despite any agreement to vary or exclude it." This provision does not apply to agreements entered into before January 1, 2004. As we discussed on our Business Law Update, this particularly affects tolling agreements and representation and warranty clauses.

It seems unlikely that the legislators intended to interfere with the freedom of contracting parties to shorten or set time limits on the periods in which warranty claims, for instance, can be made. Nevertheless it may be prudent to review these clauses in any standard form agreements, precedents or agreements under negotiation to ensure that they are drafted in such a way that they do not suggest an attempt to interfere with the limitations periods set by the legislation. In addition, account agreements with customers should be examined and shelf prospectuses for bank issuers should be reviewed for any references to limitation periods applicable to payment on the notes.

Governing Law

The question of governing law is also relevant when considering the applicable limitation period. The Act states that the limitations law of Ontario or any other jurisdiction is a matter of substantive law. This means, for example, that for a contract dispute before an Ontario court the governing law of the contract should govern the limitations issue also and for tort claims the governing limitations law would be that of the place where the tort is committed. This should alleviate some of the confusion in the case law as to whether limitations periods are substantive or procedural (the laws of the forum applying to procedural matters). Still, the conflict of laws issues will need to be carefully considered, particularly with regard to the application of section 22, as not all jurisdictions treat limitations laws as substantive (e.g. Alberta).

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